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No. 88-412

In the Supreme Court of the United States

OCTOBER TERM, 1988

MARTIN W. HOFFMAN, TRUSTEE, PETITIONER

v.

STATE OF CONNECTICUT,
DEPARTMENT OF INCOME MAINTENANCE, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

CHARLES FRIED
Solicitor General
JOHN R. BOLTON
Assistant Attorney General
THOMAS W. MERRILL
Deputy Solicitor General
CHRISTOPHER J. WRIGHT
Assistant to the Solicitor General
TRACY J. WHITAKER
Attorney

Department of Justice
Washington, D.C. 20530
(202) 633-2217

QUESTION PRESENTED

Whether Section 106(c) of the Bankruptcy Code (11 U.S.C.) permits a bankruptcy trustee to bring an action against a State in federal bankruptcy court seeking retroactive monetary relief.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-19) is reported at 850 F.2d 50. The opinion of the district court in *In re Willington Convalescent Home, Inc.* (Pet. App. A20-A71) is reported at 72 Bankr. 1002. The opinion of the district court in *In re Edward Zera* (Pet. App. A72-A97) is reported at 72 Bankr. 997. The Memorandum and Order of the bankruptcy court in *In re Willington Convalescent Home, Inc.* (Pet. App. A98-A143) is reported at 39 Bankr. 781. The opinion of the bankruptcy court in *In re Edward Zera* (Pet. App. A144-A185) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on June 15, 1988. The petition for a writ of certiorari was

filed on September 7, 1988. The jurisdiction of this court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISION INVOLVED

11 U.S.C. 106 provides:

> (a) A governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which such governmental unit's claim arose.
>
> (b) There shall be offset against an allowed claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.
>
> (c) Except as provided in subsections (a) and (b) of this section and notwithstanding any assertion of sovereign immunity
>
> (1) a provision of this title that contains "creditor", "entity", or "governmental unit" applies to governmental units; and
>
> (2) a determination by the court of an issue arising under such a provision binds governmental units.

STATEMENT

Petitioner, Martin W. Hoffman, is the trustee in two unrelated bankruptcy cases, *In re Willington Convalescent Home, Inc.*, Debtor, No. 2-82-00508, and *In re Edward Zera*, Debtor, No. 2-83-00754, pending in the United States Bankruptcy Court for the District of Connecticut. In each case, he commenced adversary proceedings in the bankruptcy court against the State of Connecticut seeking money damages. The court of appeals affirmed the district court's dismissal for lack of jurisdiction, thus rejecting the bankruptcy court's finding that 11 U.S.C. 106(c) authorizes trustees to bring suits for money damages against governmental units.

1. The Willington Convalescent Home, Inc., was a nursing home operator which participated in the Connecticut Medicaid program. After a field audit in 1980 determined that Willington had overstated its real property costs, resulting in excess reimbursements by the State for five years, the State began recouping these past overpayments from its current payments to Willington. In 1982, Willington filed a petition under Chapter 11 of the Bankruptcy Code. It continued to operate and participate in the Medicaid program until it closed in April 1983; at that time it still owed Connecticut $121,408. Although the State did not file a proof of claim in the bankruptcy court, it refused to pay Willington $64,010.24 for Medicaid services rendered in March 1983. After Willington's Chapter 11 case was converted to Chapter 7, petitioner was appointed trustee and filed a turnover action under 11 U.S.C. 542(b) (see Pet. App. A6) seeking to recover the $64,010.24 from the State. The State moved to dismiss for lack of jurisdiction. *Id.* at A5-A6.

Edward Zera, who operated a maintenance service, incurred liability to Connecticut for overdue taxes and a renewal fee. Connecticut's Department of Revenue Services issued a tax warrant, which resulted in payment of $2,100.62 to the State. After Zera filed for bankruptcy, petitioner was appointed trustee and sought to avoid the $2,100.62 payment as a preference (see 11 U.S.C. 547(b)) and to recover the money paid to Connecticut (see 11 U.S.C. 550(a)). The State again moved to dismiss for lack of jurisdiction. Pet. App. A6-A7.

2. In each case, the bankruptcy court denied the State's motion to dismiss, finding that it had jurisdiction

over the trustee's action under Section 106(c). In Willington's case, the court first noted that Section 106(c) provides that "notwithstanding any assertion of sovereign immunity (1) a provision of this title that contains 'creditor', 'entity', or 'governmental unit' applies to governmental units; and (2) a determination by the court of an issue arising under such a provision binds governmental units." The court then noted that Section 542(b), the turnover provision invoked by petitioner to compel Connecticut to turn over the $64,010.24, applies to any "entity," one of the triggering words listed in Section 106(c)(1). From that, and without any discussion of Section 106(c)(2), the court concluded that "Congress has expressly provided that a State is bound by a court judgment ordering it to make payment of a matured debt and a defense of sovereign immunity against a suit brought by a trustee is unavailing" (Pet. App. A115-A116).

Having concluded that the State was subject to suit, the court went on to consider whether, in light of the Eleventh Amendment, it was subject to suit in federal court. The court stated that Section 106(c) "clearly and unambiguously" subjects states to turnover actions, and further noted that the Code's jurisdictional provisions and general policies showed that Congress intended a bankrupt estate to "have the benefit of bringing all its litigation in the single federal forum" (Pet. App. A127-A128). The court accordingly concluded that "Congress not only waived the State's common-law sovereign immunity but intended that such waiver be enforced in the federal courts" (*id.* at A129). The court further concluded that Congress has the power under the Bankruptcy Clause, Art. I, § 8, Cl. 4, to abrogate a state's Eleventh Amendment immunity (Pet. App. A135).

In Zera's case, the court noted that the "proceeding differs significantly from *Willington* only in that the trustee's

complaint is based on § 547(b) [the preference provision] rather than § 542(b) [the turnover provision]" (Pet. App. A161). However, since the preference provision applies to "creditor[s]," another triggering word under Section 106(c)(1), the court concluded that the State was also subject to an action seeking to avoid a preferential transfer (Pet. App. A166).

3. Connecticut appealed both cases to the United States District Court for the District of Connecticut, arguing that Section 106(c) did not subject it to suit, and, if it did, that it was unconstitutional. The district court certified to the Attorney General, pursuant to 28 U.S.C. 2403, that the constitutionality of an Act of Congress had been drawn into question, and the United States intervened. The district court then reversed the bankruptcy court's decisions.

In Willington's case, the court agreed with the United States that, properly construed, Section 106(c) has a limited purpose: it " 'subjects sovereign units to bankruptcy jurisdiction and authority when the bankruptcy court acts pursuant to a specific grant of authority where relief of an injunctive and declaratory nature can be imposed or when the dispute arises within the bankruptcy court's in rem jurisdiction' " (Pet. App. A64-A65 n.22 (quoting U.S. Br. 9)). That reading is based on the language of Section 106(c)(2), which, unlike Sections 106(a) and (b), does not authorize "claims" but instead provides that "a determination by the court of an issue arising under such provision [*i.e.*, a provision containing one of the triggering terms listed in Section 106(c)(1)], binds governmental units." In addition, as the district court stressed (Pet. App. A42), it is difficult to harmonize the bankruptcy court's broad interpretation of Section 106(c) with Sections 106(a) and (b). Section 106(a) authorizes compulsory counterclaims against governmental units *if*

the agency has filed a proof of claim in the bankruptcy proceeding, and Section 106(b) authorizes permissive counterclaims for offset purposes, "but, again, only *after* the sovereign files its own proof of claim" (Pet. App. A43 (emphasis in original)). "The express waiver of sovereign immunity in the carefully limited circumstances provided for in subsections (a) and (b) would seem to preclude reading subsection (c) as a completely independent wide-open waiver of sovereign immunity which would permit suits against the state for retroactive money damages irrespective of whether the state had first brought suit against the estate" (*id.* at A43-A44). Noting that "waivers of sovereign immunity must be strictly construed in favor of the sovereign" (*id.* at A45-A46), particularly where the Eleventh Amendment is at issue, the court concluded that the bankruptcy court lacked jurisdiction over petitioner's turnover claim (*id.* at A69).

In Zera's case, the district court relied on its decision in *Willington*. The court again agreed with that the United States (Pet. App. A94) that Section 106(c) authorizes preference actions against governmental units only where the bankruptcy court has in rem jurisdiction, such as when a trustee seeks to set aside a preferential lien of a sovereign on property within the estate. The court concluded, like the United States, that nothing in the Bankruptcy Code showed that Congress plainly intended "to abrogate the states' immunity to suit in bankruptcy court for recovery of funds from the state treasury" by means of an action to avoid a preference (*id.* at A95). The court acknowledged (*id.* at A92) that the Seventh Circuit had reached a contrary conclusion *In re McVey Trucking, Inc.*, 812 F.2d 311 (1987), cert. denied, No. 86-1847 (Oct. 13, 1987). As in *Willington*, the district court found it unnecessary to discuss whether Congress has the power under the Bankruptcy Clause to abrogate states' immunity.

4. The court of appeals, after consolidating the cases, affirmed the district court's conclusion that the bankruptcy court lacked jurisdiction over petitioner's claims (Pet. App. A1-A19). The court focused on the language of Section 106(c)(2), which "provides only that governmental units are *bound* by 'a *determination* by the court of *an issue* arising under' a provision containing one of the 'triggering' terms enumerated in subsection (c)(1)" (Pet. App. A12 (emphasis in original)). "[P]articularly when read in light of § 106(a) and (b)," the court said, it seems plain that Section 106(c) "waives state sovereign immunity only to the extent necessary for the bankruptcy court to determine a state's rights in the debtor's estate" (*id.* at A12-A13).

The court of appeals found support for its conclusion in the legislative history, which makes clear that the primary purpose of Section 106(c) was to codify the results in *In re Gwilliam*, 519 F.2d 407 (9th Cir. 1975), and *In re Dolard*, 519 F.2d 282 (9th Cir. 1975), where the courts held that bankruptcy courts may determine the amount and dischargeability of unpaid taxes. Both the Senate and House bills had preserved sovereign immunity for tax authorities. S. Rep. 95-1106, 95th Cong., 2d Sess. 6 (1978); H.R. Rep. 95-595, 95th Cong., 1st Sess. 317 (1977). Thus, if the holdings of *Gwilliam* and *Dolard* were to be preserved, it was necessary to add Section 106(c) to provide that bankruptcy courts could issue binding determinations with respect to tax liabilities. Members of the Conference Committee stated that this was in fact the primary purpose of Section 106(c). See 124 Cong. Rec. 32394 (1978) (statement of Rep. Edwards); *id.* at 33993 (statement of Sen. DeConcini). Nothing in the legislative history, the court of appeals stated, "indicate[d] that the scope of the sovereign immunity waiver was intended to extend beyond *determinations* of the bankruptcy court" and to allow original

actions against a State for money damages (Pet. App. A15 (emphasis in original)).

Moreover, since "statutes that purport to waive immunity construed are strictly construed in the sovereign's favor" (Pet. App. A17), and Congress must abrogate Eleventh Amendment immunity with particular clarity, the court held that governmental units are not subject "to adversarial proceedings in bankruptcy that involve payment of * * * funds to the estate," except as provided in Section 106(a) (Pet. App. A17). Like the district court, the court of appeals noted (*ibid.*) that the Seventh Circuit had reached a contrary conclusion in *McVey,* which, like Zera's case, involved a preference action, and that the Third Circuit had reached a contrary conclusion in *In re Vazquez,* 788 F.2d 130 (1986), cert. denied, No. 86-5467 (Nov. 3, 1986), which involved an action to recover a debt collected in violation of 11 U.S.C. 524(a), which is comparable to the turnover action petitioner seeks to bring on behalf of Willington.

ARGUMENT

Although the court of appeals correctly concluded that Section 106(c) does not provide jurisdiction for petitioner's suits, review by this Court is warranted because the courts of appeals are divided on the question presented, which involves a recurring issue of substantial importance to trustees in bankruptcy and to state and federal agencies.

1. As the lower courts acknowledged (Pet. App. A17, A92), the decision below is in direct conflict with the Seventh Circuit's decision in *McVey.* In addition, as the court of appeals noted (*id.* at A17), its decision is inconsistent with the Third Circuit's decision in *Vazquez,* where the court decided, after considering the issue only in passing, to give Section 106(c) a "broad interpretation" (788 F.2d at 133) encompassing authority to bring suit to recover a debt collected in violation of 11 U.S.C. 524(a).

In concluding that trustees may seek to obtain money from state agencies by means of preference actions, the Seventh Circuit in *McVey,* like the bankruptcy court below, ignored the language of Section 106(c)(2). As the court of appeals below concluded, that language is properly read as confining the scope of Section 106(c)'s waiver of sovereign immunity to actions where a bankruptcy court seeks to bind a government agency to a determination not requiring a payment of money from the agency to the bankrupt estate. That reading harmonizes Section 106(c) with Sections 106(a) and (b), and finds additional support in the legislative history explaining the Conference Committee's decision to add Section 106(c).

The Seventh Circuit rejected the argument that its broad reading of Section 106(c) rendered Sections 106(a) and (b) superfluous, explaining that Sections 106(a) and (b) "concern cases in which a state, by filing a proof of claim, consents to have claims adjudicated by the bankruptcy court," whereas by Section 106(c) Congress "create[d] a cause of action against an unconsenting state" (812 F.2d at 327 (footnote omitted)). That is no answer at all, since Section 106(c), as read by the Seventh Circuit, allows suits against states whether or not they file a proof of claim. To be sure, as court below acknowledged, petitioner's reading of Section 106(c) would not render Sections 106(a) and (b) completely redundant, since Section 106(c), unlike Sections 106(a) and (b), applies only to Code provisions containing the triggering terms listed in Section 106(c)(1) (Pet. App. A13 n.5). Nevertheless, petitioner's interpretation of Section 106(c) would encompass most claims that would be brought against a sovereign by a bankruptcy trustee; tort claims would be authorized by Section 106(a) and (b), but

not Section 106(c), but they are much less common in bankruptcy cases than contract claims. In practice, therefore, petitioner's broad reading, endorsed by the Seventh Circuit and the bankruptcy court below, would largely swallow most of the rule established by Sections 106(a) and (b), which is that governmental units are subject to suit for money damages only when they have filed a proof of claim. The narrow language of Section 106(c), along with its sparse legislative history, which primarily focused on the *Gwilliam* and *Dolard* decisions, is not compatible with an interpretation of Section 106(c) that renders governmental units subject to suits for money damages in any contract action, whether or not they file a proof of claim.

The Seventh Circuit also relied on a statement in the legislative history that Section 106(c) " 'permits a . . . debtor in possession to assert avoiding powers under Title 11 against a government unit.' " 812 F.2d at 327 (quoting 124 Cong. Rec. 32394 (1978) (statement of Rep. Edwards); *id.* at 33993 (statement of Sen. DeConcini)). That statement, however, is properly read as recognizing that Section 106(c) authorizes preference actions against governmental units in cases where the bankruptcy court has in rem jurisdiction, such as where the trustee seeks to set aside a preferential lien on property held by the estate. It should not be taken as suggesting that any preference action, including the action whereby petitioner sought to recover $2,100.62 from the State on behalf of Zera's estate, is authorized.

2. The question of the proper interpretation of Section 106(c) is important to bankruptcy trustees and to state and federal agencies. Cases involving suits like those brought by petitioner, where trustees seek to recover money from state agencies, arise frequently and, in addition to the conflict in the circuits, the district courts and bankruptcy

courts have reached various conclusions as to the reach of Section 106(c). Compare *In re Lawson Burich Ass'n*, 59 Bankr. 681 (Bankr. S.D.N.Y. 1986); *In re Crum*, 20 Bankr. 160 (Bankr. D. Idaho 1982); *In re Regal Construction Co., Inc.*, 18 Bankr. 353 (Bankr. D. Md. 1982); *In re Ramos*, 12 Bankr. 250 (Bankr. N.D. Ill. 1981); and *In re Community Hospital of Rockland County*, 5 Bankr. 11 (S.D.N.Y. 1980); with *In re Maytag Sales & Serv., Inc.*, 23 Bankr. 384 (Bankr. W.D. Ga. 1981); *In re Community Hospital of Rockland County*, 15 Bankr. 785 (Bankr. S.D.N.Y. 1981); and *In re Remke, Inc.*, 5 Bankr. 299 (Bankr. E.D. Mich. 1980). While this case involves an action against a state agency, the same result will presumably obtain in cases where trustees seek money from federal agencies, since Section 106(c) applies to "governmental units," which are defined to include federal as well as state agencies (11 U.S.C. 101(26)). The question presented is therefore of considerable interest to the federal government.

Although the court below noted the especially heavy presumption against waivers of Eleventh Amendment immunity (Pet. App. A16-A18), and the respondent in *Pennsylvania* v. *Union Gas Co.*, No. 87-1241 (argued Oct. 31, 1988), has asked this Court to reconsider its Eleventh Amendment jurisprudence, we see no good reason to hold this case pending a decision in that case. The threshold question of statutory construction, as to which the courts of appeals have divided, must be resolved before any question of Eleventh Amendment immunity is considered. If the Court concludes, as we urge, that the construction adopted by the court below is correct, then the Eleventh Amendment issues need not be reached. On the other hand, if the Court agrees with petitioner's reading of the statute, then the Court can either dispose of the Eleventh Amendment issue in light of the principles established in

Pennsylvania v. *Union Gas,* or can remand to the court of appeals for application of those principles, as it sees fit.

In our view, moreover, the statutory construction issue can be resolved on the basis of the text and legislative history of Section 106(c), without the need to resort to any presumptions governing statutory construction derived from the Eleventh Amendment. No matter how the Court disposes of the issue presented in *Pennsylvania* v. *Union Gas*, the general presumption in favor of reading waivers of sovereign immunity narrowly, which was cited by both the court of appeals (Pet. App. A17) and the district court (*id.* at A45-A46), will remain and weigh against adoption of petitioner's interpretation of Section 106(c).

Finally, we do not think that the arguments advanced in Connecticut's brief in opposition make review inappropriate. Connecticut argues primarily (Pet. 5) that this is a poor case to resolve the question whether Congress has the power to abrogate Eleventh Amendment immunity under the Bankruptcy Clause, since the court of appeals and the district court below did not address the issue. The question that we think warrants review, however, is whether the court of appeals properly construed Section 106(c). If the court's decision is correct, then it is not necessary to reach any Eleventh Amendment question at all, including the question whether Congress has the power to abrogate the Eleventh Amendment under the Bankruptcy Clause. In any event, that question was analyzed in detail in *McVey* (812 F.2d at 314-323), and was addressed by the many courts cited in the bankruptcy court's discussion of the issue (Pet. App. A129-A136).

Connecticut also notes that, in the Willington case, the district court found "that the terms of Willington's contract with Connecticut entitled the state to recoup past overpayments to Willington by withholding the funds due for services provided in March 1983" (Pet. App. A71).

Connecticut argues that this is an independent ground supporting the district court's decision (Pet. 7). Even if this were such an independent ground, it would have no application to Zera's case, on which there is a precise conflict with the Seventh Circuit's decision as to whether trustees may seek to set aside a preferential transfer and recover money from a governmental unit. Moreover, the court of appeals in fact did not rely on the district court's finding, so it cannot be regarded as an alternative basis for its decision even with respect to Willington's case. In addition, the district court's short statement does not appear to be an alternative holding, but merely a finding of fact that would have aided the court of appeals, had it construed Section 106(c) differently than the district court, in determining whether, as a matter of law, there was merit to petitioner's turnover action.

CONCLUSION

The petition for writ of certiorari should be granted.

CHARLES FRIED
Solicitor General
JOHN R. BOLTON
Assistant Attorney General
THOMAS W. MERRILL
Deputy Solicitor General
CHRISTOPHER J. WRIGHT
Assistant to the Solicitor General
TRACY J. WHITAKER
Attorney

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